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Financial Digest

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Analysis of Business Trends Plus Selected Financial Indicators

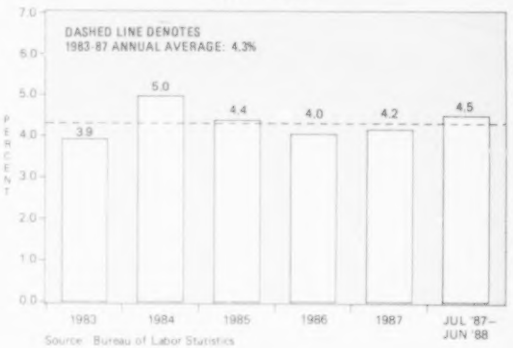
Inflation Fears Seem Exaggerated

As memories of last October's global stock market collapse fade, the principal concern of the financial markets has shifted from the prospect of recession to the potential for accelerating inflation. Notwithstanding–the fact that the annual rate of inflation has remained below four percent every year from 1982 through 1986, a year when the consumer price index (CPI) advanced by a mere 1.1 percent, and that 1987's rise in the CPI was only 4.4 percent, uneasiness about the inflation outlook continues to dominate Wall Street's thinking. However, while tightening labor markets, higher industry operating rates and rising commodity prices have fueled inflation expectations, several other mitigating factors, ranging from softening oil prices to subdued wage increases to consumer resistance to higher prices should be sufficient to blunt inflation pressures.

The modest increase in consumer prices in June bolstered the position of those who contend that today's inflation fears are exaggerated. According to the Labor Department, consumer prices rose by 0.3 percent in June month-over-month, the same rate of rise as in May, largely due to a hefty runup in the prices of such food items as meat, poultry and eggs. Although the increase in poultry prices reflected to some extent the effects of the drought in the Midwest, there were few other signs of the unusual dry spell; in any event, a good chunk of the increase in food costs was offset by declines in energy and apparel prices.

Perhaps more important were two other items contained within the consumer price report. For one thing, average hourly earnings remained unchanged in June, indicating that wage pressures, even with the unemployment rate standing at a 14-year low, are fairly well contained. Since labor costs make up two-thirds of business costs, moderate wage gains are a decided plus in the inflation outlook. For another, consumer prices, excluding the volatile food and energy components, continue to advance at not only a restrained clip, but a remarkably stable one as well. While the 0.4 percent June gain was faster than May's 0.2 percent advance, over the past year this "core" inflation rate was 4½ percent, just a shade higher than the 1983-1987, five-year average of 4.3 percent (see chart).

PERCENTAGE CHANGE IN THE CONSUMER PRICE INDEX
EXCLUDING FOOD AND ENERGY
1983 – PRESENT



Source: Bureau of Labor Statistics

Oil Prices Brighten the Outlook

Consumer price behavior in June provides a glimpse of what might occur over the balance of this year–stable to lower energy prices and moderate wage gains keeping overall inflation in check, despite the periodic ringing of alarm bells in the financial press and on Wall Street. Take, for example, the likely trend in oil prices. Even before the cease fire between Iran and Iraq was announced oil prices were heading lower. Although some believe that peace in the Middle East could boost oil prices, it appears a better bet that these two war-weary countries will attempt to repair their oil-producing facilities quickly, begin pumping as much oil as possible and start making up for a lost decade of development. If successful, this will have a significant impact on an already saturated global oil market. At their respective peaks in the mid-1970s, these two countries produced over eight million barrels a day, almost twice their recent combined output. Unless matched by output declines elsewhere, this could depress oil prices by several dollars a barrel–holding down inflation in the process.

As far as other commodities are concerned, prices of industrial raw materials appear to have topped out, moving essentially sideways

Manufacturers Hanover Economics Department 17/270

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in recent weeks. Even on the food front, the picture may not be so bleak. Recent rains have rescued a good part of the crops threatened by drought, and those crops that have been reduced are either in good supply in the government's storage bins and/or available from other countries. What is more, the prices of some food products are actually falling as a result of the drought. Although rising meat prices contributed to the escalation of food prices in June, with ranchers stepping up shipments of meat animals to market in order to avoid significantly higher feedgrains' costs, the upturn in meat prices should soon be reversed.

The Economy Has Room to Grow

While commodity price trends provide insufficient evidence that inflation is about to sharply accelerate, tightening labor markets and rising industry operating rates do suggest that the direction of inflation will be higher, rather than lower. But the critical questions of how soon, and how much persist. For while the jobless rate currently stands at a 14-year low—a point repeatedly referred to by the inflation bears—the fact is that the unemployment rate has often been lower, averaging 4¾ percent from 1948 through 1973. However, this period enjoyed both low inflation rates and low unemploy-

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits of $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/13/88)	184,458	+ 1,397	+ 8,237
New York City (7/20/88)	37,826	+ 25	+ 828
Commercial Paper (7/20/88)	419,166	+ 3,670	+ 74,059

Bank Loans

(Millions of Dollars)

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Commercial and Industrial Loans			
Nationwide (7/13/88)	299,134	– 3,027	+13,564
New York City (7/20/88)	57,979	+ 875	+ 47
Total Loans and Leases Gross Adjusted			
Nationwide (7/13/88)	891,493	– 3,958	+46,499
New York City (7/20/88)	175,174	+ 1,024	–25,659

Financial Markets

	Friday 7/29/88	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.15%	+ .21	+ .93
180-Day Bills†	7.48	+ .11	+ 1.07
Longest Bills†	7.88	+ .15	+ 1.07
Recent Issues:			
83/8S 7/31/90 (When Issued)	8.36	NA	
81/4S 6/30/92	8.62	+ .03	
9S 5/15/98	9.11	+ .01	
91/8S 5/15/18	9.21	+ .01	
Municipals:			
Bond Buyer–20 Bond Index* (7/28/88)	7.76%	– .01	+ .03
Blue List Total ($ Million)	$1,375	– $ 2	–$ 408
30-Day Visible Supply ($ Million)	$1,150	– $442	–$ 425
Total	$2,525	– $444	–$ 833
Corporates:			
Moody's Aa Composite (7/28/88)	10.33%	+ .01	+ .55
30-Day Visible Supply ($ Million)	$1,617	– $375	–$1,193
Stocks:			
*Dow-Jones Averages:			
Industrials	2,128.73	+ 67.74	–443.34
Transportation	886.20	+ 28.82	–190.46
Utilities	182.85	+ 7.35	– 18.90
65 Stocks	794.39	+ 26.41	–156.93
N.Y.S.E. Composite Index	153.35	+ 4.10	– 25.29
N.Y.S.E. Avg. Daily Vol. for Week (000's)	164,206	+ 13,950	–17,936

*34% Taxable equivalent 11.76%. † Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 7/29/88	Week Ago
Overnight	7.69%	7.69%
1 month	8.00	7.94
3 month	8.31	8.25
6 month	8.50	8.50
1 year	8.75	8.69

FOREIGN EXCHANGE SPOT RATES New York Opening (7/29/88)	Currency Per U.S. $	Week Ago
Belgium	39.04	38.25
Canada	1.2105	1.1973
France	6.3350	6.1510
Germany	1.8665	1.8292
Italy	1377.00	1353.50
Japan	132.75	130.95
Mexico	2273.00	2273.00
Netherlands	2.1065	2.0640
South Korea	723.70	724.30
Switzerland	1.5530	1.5205
Taiwan	28.63	28.63
U.K.*	1.7160	1.7347

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (7/29/88) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	+1.3%	–2.0%

ment; consumer price increases averaged just 2½ percent annually during these years.

So, too, today's industry operating rates might be less of an immediate threat than appears at first glance. The eight-year high reported for capacity utilization in June is high only in comparison with the past eight years. In late 1978, the ratio was nearly four points higher and, during the 1960s, was above 90 percent on more than one occasion. To be sure, while a few industries are operating at, or close to capacity, most are not.

Finally, a sustained price spiral seems unlikely unless the consumer plays along, and consumer resistance to price increases still appears to be the order of the day. The price index that is a part of the GNP accounts has risen at an annual rate of less than three percent during the first half of this year, far slower than the CPI's nearly 4½ percent jump. Since GNP-based deflators measure prices only of those goods consumed, the implication of the slower rise of the GNP price index is that people are shunning those goods whose prices are rising rapidly in favor of those whose prices are going up more slowly, or not at all. ■

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 7/27/88	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	231.527	– 1.907	+18.452
Loans to Depository Inst.	3.398	+ .260	+ 2.602
Float	.864	+ .041	+ .337
Total Reserve Bank Credit	251.467	– 1.191	+21.136
Treasury Deposits with Federal Reserve Banks	3.594	+ .385	– .278
Currency in Circulation	234.880	– 1.145	+19.457
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	224.329	– .116	+47.394
	7/27/88		
Member Bank Reserves:			
Total Reserves Held	61.137	– 1.036	+ 4.062
Excess (Deficiency)	1.293	+ .419	+ .310
Net Free Reserves	.696	+ 1.138	+ .232
Monetary Aggregates †		‡ % Change Since 3 Months Ago*	‡ % Change Since Year Ago
M1 (7/18/88)	781.4	+ 7.4	+ 5.0
M2 (7/18/88)	3,023.6	+ 5.0	+ 5.9
M3 (7/18/88)	3,819.8	+ 5.4	+ 6.4
Domestic Nonfinancial Debt (1st Q'88)	8,541.7	+ 8.2	+ 9.3

† Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 7/29/88	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	6.97%	7.13%	7.37%
* Federal Agencies	7.75	7.85	7.95
* Municipal Notes—High Grade (34% Taxable Equivalent)	7.95	8.71	9.09
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	8.20	8.50	8.70

‡ Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	7.00%	Sep.	7.83%
15- 29 days	7.38	Oct.	7.88
30- 59 days	7.50	Nov.	7.92
60- 89 days	7.63	Dec.	7.98
90-179 days	7.63	Jan.	8.00
180-239 days	7.70	Feb.	8.05
240-270 days	7.70		

‡ Industrial Paper—Prime			
30- 89 days	7.88%	† Federal Funds Effective Rate	7.80%
90-120 days	8.08		

‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'88n	$ 4,807	$ 4,725r	$ 4,484r
Gross National Product (1982 Dollars)*	2nd Q'88n	$ 3,986	$ 3,956r	$ 3,823r
Percent Change, Annual Rate	2nd Q'88n	3.1	3.4r	5.0r
Change in Consumer Prices*	Jun '88n	3.6%	3.6%	3.6%
Change in MH Cost of Living Index	Jun '88n	4.8%	4.8%	3.6%
Change in Producer Prices*	Jun '88	4.8%	6.0%	1.2%
Civilian Employment (Thousands of Persons) †	Jun '88	115,018	114,195	112,300
Unemployment as % of Civilian Labor Force †	Jun '88	5.3%	5.6%	6.1%
Personal Income*	Jun '88n	$ 4,042	$ 4,014r	$ 3,747r
Leading Indicators Composite Index (1967=100) †	May '88	192.6	192.8	188.6
Industrial Production Index (1977=100) †	Jun '88	136.6	136.1	129.1
Net Change in Consumer Installment Credit †	May '88	$ 2.42	$ 3.85	$ 1.16
U.S. Merchandise Trade Balance †	May '88	–$ 10.93	–$ 10.30	–$ 14.07
Plant and Equipment Expenditures*	3rd Q'88	$438.22(a)	$429.01(a)	$393.13
Private Housing Starts (Thousands of Units)*	Jun '88n	1,384	1,576	1,599
New Construction Expenditures*	May '88	$ 407.1	$ 402.7	$ 397.9
Total Business Inventories †	May '88	$ 728.4	$ 724.0	$ 677.3
Total Business Sales †	May '88	$ 483.7	$ 479.5	$ 448.5

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

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